

**DEPARTMENT OF VETERANS AFFAIRS**

OFFICE OF THE SECRETARY

POST OFFICE BOX 942895

SACRAMENTO, CALIFORNIA 94295-0001

Telephone: (916) 653-2158

Fax: (916) 653-2456



August 18, 2011

The Honorable Lou Correa  
California State Senate  
Senate Veterans Affairs Committee  
1020 N Street – Room 251  
Sacramento, CA 95814

The Honorable Paul Cook  
California State Assembly  
Assembly Veterans Affairs Committee  
1020 N Street – Room 389  
Sacramento, CA 95814

Dear Senate Member Correa and Assembly Member Cook,

In accordance with Sections 987.2; 989.1 and 989.7 of the Military and Veterans Code, attached is the Annual Report to the Legislature regarding the CalVet Insurance Plans. The report is due on September 1, 2011.

The Department is pleased to report that all of the Home Protection programs are financially stable. All the insurance programs are projected to be secure for the next five years, with only minor revisions.

If you have any questions about this report, please contact Jim Lowrey, Deputy Secretary of the Farm and Home Purchases Division, at (916) 503-8318.

PETER J. GRAVETT  
Secretary

Jl/JL/PG:em

Enclosure: Annual Report to the Legislature 2011

Cc: Mr. Gregory Schmidt  
Secretary of the Senate  
State Capitol, Room 400  
Sacramento, CA 95814  
Cc: Mr. E. Dotson Wilson

HONORING CALIFORNIA'S VETERANS

Chief Clerk of the Assembly  
State Capitol, Room 3196  
Sacramento, California 95814

Cc: Diane F. Boyer-Vine  
Legislative Counsel Bureau  
State Capitol, Room 3021  
Sacramento, CA 95814

Cc: Shawn Martin  
Legislative Analyst's Office  
925 L Street, Suite 1000  
Sacramento, CA 95814

Cc: John Fitzpatrick  
Principal Program Budget Analyst  
Department of Finance  
915 L Street  
Sacramento, CA 95814

Cc: Willem Schaafsma  
Finance Analyst  
Department of Finance  
915 L Street  
Sacramento, CA 95814

# **ANNUAL REPORT**

## **CALVET INSURANCE PLANS**

**Report Pursuant to  
Military and Veterans Code  
Sections 987.2; 989.1 and 989.7**

**Fiscal Year 2010-2011**

**Submitted:  
September 1, 2011**

**California Department of Veterans Affairs  
1227 "O" Street  
Sacramento, California 95814**

## **Table of Contents**

<b>Introduction</b>	<b>Page i</b>
<b>Executive Summary</b>	<b>Page 1</b>
<b>CalVet Pooled Self-Insurance Fund</b>	<b>Page 3</b>
<b>Fire and Hazard Real Property Insurance</b>	<b>Page 4</b>
<b>Disaster Indemnity Coverage</b>	<b>Page 8</b>
<b>Self-Insured Life and Disability Coverage</b>	<b>Page 11</b>
<b>Commercial Life and Disability Coverage</b>	<b>Page 12</b>
<b>Loan Insurance</b>	<b>Page 13</b>
<b>USDVA Guaranty Program</b>	<b>Page 14</b>
<b>Primary Mortgage Insurance (PMI)</b>	<b>Page 15</b>
<b>CalVet Insurance Unit</b>	<b>Page 16</b>
<b>Conclusion</b>	<b>Page 16</b>

# **INSURANCE COVERAGE UNDER THE CALVET LOAN PROGRAM**

## **Introduction**

The California Department of Veteran Affairs (CDVA or Department) insurance report is submitted in compliance with Sections 987.2; 989.1 and 989.7 of the Military and Veterans Code of the State of California (the Code), as amended by the Statutes of 2009, Chapter 502. Those statutes require CDVA to report annually to the Legislature regarding any insurance coverage implemented or required by it. This includes any insurance purchased to support or supplement the Indemnity Fund, established under Article 3.8 of the Code, entitled Disaster Indemnity; and any insurance purchased to support or supplement the Pooled Self-Insurance Fund, established under Article 3.7 of the Code.

This report provides information on the following plans for protection of CalVet purchasers and the CDVA against unforeseen occurrences:

**FIRE AND HAZARD - REAL PROPERTY INSURANCE  
DISASTER INDEMNITY COVERAGE  
LIFE AND DISABILITY COVERAGE  
PRIMARY MORTGAGE INSURANCE**

## **Executive Summary**

All of the Home Protection programs are financially stable, and will continue to be solvent for the next five years unless there are drastic, unforeseen changes to the size of our loan portfolio. Only minor revisions will be made to improve program compliance and performance.

### **CalVet Pooled Self Insurance Fund**

In October 2009 the Governor signed AB 1051, Fletcher, which was sponsored by the Department and established the CalVet Pooled Self-Insurance Fund in Military & Veterans Code Sections 989 and 989.1. This statute provides that the four CalVet self insured programs be pooled. This Pooled Fund was implemented on July 1, 2010 and it will help CDVA to maintain additional stability of the CalVet Home Loan program.

### **CalVet Property Claims Adjuster**

In March 2010, the Department initiated a competitive bid process for the CalVet Property Claims Adjuster. This process was completed in August and the successful bidder, Sams & Associates, started a new three year contract on October 31, 2010.

### **Property Insurance Premiums**

The property insurance premium charged by CDVA to CalVet contract holders has not changed in the past year. The current annual rate for the Fire & Hazard Insurance coverage is \$1.45 per \$1,000 of insured value, and the Disaster Indemnity Coverage (Earthquake & Flood) is \$1.50 for a total rate of \$2.95 per \$1,000 of insured property value. This insurance rate is very competitive and provides broader coverage than most property insurance carriers provide to homeowners.

### **Self-Funded Life and Disability Program**

The liability for the legacy (vested) Self-Funded Life and Disability program is fully funded based on the current actuarial estimates. We will continue to monitor this benefit to make sure that the mortgage is paid for these disabled CalVet contract holders.

### **Primary Mortgage Insurance**

During 2008, all commercial Primary Mortgage Insurance (PMI) carriers in California were downgraded by the rating agencies, and the few with acceptable ratings refused to write PMI coverage on homes in California. This makes PMI companies of little value in supporting the

CalVet bond ratings. This situation has not changed since 2008. As a result, the Department is continuing to explore alternative methods of providing such coverage. In the meantime, the Department is self insuring those CalVet borrowers whose loan to value (LTV) exceeds 80% and who are unable to comply with USDVA loan guarantee requirements.

### **Property Insurance Program Change**

During 2009 and 2010, the Department reviewed and analyzed the option of moving the CalVet Property Insurance program from the Commercial Excess Insurance marketplace to the Reinsurance marketplace. Our broker, Marsh of San Francisco and their sister firm, Guy Carpenter Reinsurance Brokers of Seattle, completed the research and analysis of this transition. Based upon their analysis and recommendation, CalVet has combined the Fire & Hazard and Disaster Indemnity property insurance into one Reinsurance program with annual premium savings of over \$1.4 million. In addition, by moving to Reinsurance, the CalVet property insurance program has gained more security through greater diversity of insurance carriers and a greater spread of the risks. The change in property insurance coverage from Commercial Excess Insurance to Reinsurance was made effective September 1, 2010. This major change was made possible, in part, due to the implementation of the CalVet Pooled Self Insurance Fund under AB 1071 by Fletcher in 2009.

## **CalVet Pooled Self Insurance Fund**

In October 2009 the Governor signed AB 1051, Fletcher, which was sponsored by the Department and established the CalVet Pooled Self-Insurance Fund in Military & Veterans Code Sections 989 and 989.1. This statute provides that the following CalVet self insured programs will be pooled:

- 1) The Disaster Indemnity Fund, as authorized in M&V Section 989.4;
- 2) The Fire & Hazard insurance account authorized in M&V 987.74 and 987.76;
- 3) The Self Insured (Legacy-vested) Life & Disability program authorized in M&V Sections 987.25 and 987.88; and
- 4) The Mortgage Reserve (aka Primary Mortgage Insurance) program authorized in M&V Sections 987.71 and 987.76.

Under the provisions of this statute, the Department has combined the moneys from the four funds into one fund effective July 1, 2010, although the moneys in each sub-fund remain separately maintained for accounting purposes. This will allow for the sharing of reserves of the four accounts, and in the event of multiple major disasters, protect the CalVet Home Loan Program's operating fund and the Farm and Home Building Fund of 1943 (the 1943 Fund) from the risk of defaulting on bond debt service payments. All funds are to be audited on a biennial basis. This audit will assure that each sub-fund is financially solvent, and if there is intra-fund borrowing, to make sure that each sub-fund is made whole within three years. These audits will also help to adjust rates so that each sub-fund can continue being financially sound. There has been no borrowing between sub-funds since the inception of the Pooled Fund.

As of June 30, 2011, each of the four self insured sub-funds had the following amounts in them:

- |   |                     |
|---|---------------------|
| 1. The Disaster Indemnity Fund (for Earthquake and Flood):  | \$16,656,718        |
| 2. The Fire & Hazard Insurance Account:                     | \$3,009,670         |
| 3. The Life & Disability Legacy-vested program:             | \$2,404,575         |
| 4. The Mortgage Reserve (PMI) program:                      | \$5,433,600         |
| <b>Total Amount in the CalVet Pooled Self Insured Fund:</b> | <b>\$27,504,563</b> |



## **Fire and Hazard Real Property Insurance**

Fire and Hazard insurance is provided to CalVet contract purchasers with the primary portion of the risk self-funded and supported by the new CalVet Pooled Self Insurance Fund. Until September 1, 2010, commercial excess insurance was purchased to protect our property portfolio against unexpected, high-loss occurrences under a one-year master policy issued by the Allianz Insurance Company, which is a highly rated company. The excess insurance policy contract discussed in this report became effective October 31, 2009 and was cancelled effective September 1, 2010 when the CalVet Home Loan portfolio became Reinsured with eight (8) highly rated insurers, both domestic and international, including Lloyd's of London and the Bermuda market. Certificates are issued annually under the master policy to cover individual CalVet homes and farm properties. This coverage excludes earthquake and flood losses, which are covered under the Disaster Indemnity Coverage (DIC) program.

Mobile/manufactured homes, both in parks and on land owned by the contract purchaser, are excluded from this coverage. Purchasers of mobile/manufactured homes must obtain fire and hazard coverage from another source, with CDVA named as the loss payee. Also excluded are condominiums and planned-unit development (PUD) properties, which are covered by blanket insurance policies that are provided by homeowners' associations that protect our portfolio against losses by way of a Loss Payable Endorsement Clause.

Additionally, under a separate contract between CDVA and Donald K. Sams and Associates, Inc. (Sams), an independent adjusting company, Sams is authorized and responsible to adjust claims and issue the claim payment drafts for losses to CalVet properties protected under the Fire and Hazard Program.

Premiums paid by our contract holders are maintained in a self-insured retention fund to cover losses up to the \$2 million deductible per occurrence. Our reinsurance carriers would be responsible to pay losses that exceed the deductible up to a total of \$50 million (\$48 million in reinsurance above the \$2 million deductible), which protects CalVet from catastrophic losses. Additionally, the CalVet properties covered through the Fire and Hazard Program are provided Guaranteed Replacement Cost coverage. Guaranteed Replacement Cost ensures a CalVet contract holder will be able to fully replace the insured home with like kind and quality in the event of a loss, regardless of the stated dollar limits of insurance coverage for the home. However, outbuildings such as work sheds or barns are protected on an "actual cash value" (ACV) basis and not the full replacement cost.

The current annual cost to the CalVet contract holder for Fire and Hazard insurance is \$1.45 per \$1,000 of insured value. This rate has not changed since February 1, 2007, when it was reduced from \$2.20 per \$1,000 of insured value, which was a reduction in premium of \$0.75 per \$1,000 of replacement cost value. It should be noted that some major insurance companies have raised premium rates for homeowners insurance and often cancel coverage, or refuse to renew, if the insured has had three or more losses within the previous five years. CalVet does not increase premiums or cancel coverage on individual contract purchasers due to the number of claims filed. Many companies charge higher premiums in high-risk areas; CalVet does not.

The premium paid by the CDVA on October 31, 2009, for the excess Fire coverage was \$612,656. Upon cancellation of that policy on September 1, 2010, the insurance carriers paid CalVet \$83,872.52 in return premium. On a prorated basis for the Fiscal Year, this ten month Fire policy cost CalVet approximately \$104,152\*. The premium paid by CDVA on September 1, 2010 for the combined Fire and Disaster Reinsurance was \$3,015,000. After allocation of that amount for the Fire insurance versus the Disaster insurance\*\*, and prorating for the Fiscal Year, the Fire Insurance portion of the Reinsurance premium was approximately \$441,432\*\*\*. Therefore, the total approximate excess Fire and reinsurance Fire premium was \$545,584 (\$104,152 + \$441,532) for FY 2010/2011. Premiums paid by CalVet contract holders (into the self-insured retention fund) during the 2010/2011 fiscal year totaled \$3,890,078. Actual paid Fire and Hazard claims and expenses during the 2010/2011 fiscal year totaled \$2,751,121, which calculates into a combined loss ratio of 70.7%. (Please refer to the list below for more detailed information.)

Subrogation recoveries from third parties totaled \$135,010, with a net amount of \$100,895 returned to CDVA.

The total cost to operate the Fire and Hazard insurance program, exclusive of departmental personnel costs for administering the program during the 2010/2011 fiscal year, was \$3,435,970, which is based upon the following information:

• Paid claims	\$2,751,121
• Claims Adjusting Service Fees (Fire & H.) (Sams)	\$240,060
• Prorated Excess Fire Insurance (Marsh)	\$104,152
• Prorated Fire Reinsurance (Marsh)	\$441,532
• Less Net Recoveries from Subrogation	(\$100,895)
 Total	 \$3,435,970

This includes adjusting costs, excess policy premium, claims expenses, legal fees (if any) and administrative fees, less subrogation recoveries, but excluding any future change in reserve estimates for losses incurred but not reported at the end of the year. Under the new CalVet Pooled Self Insurance Fund program effective July 1, 2010, the Self Insurance Fund, and not the Department's Operating Fund, would be used to cover any shortfalls between premiums collected from contract holders and operating costs. For fiscal year 2010/2011, the net gain to operate the Fire and Hazard Insurance program was \$454,108 (\$3,890,078 - \$3,435,970).

The Department updated replacement cost values in January 2006 on all CalVet homes, and continues to update property valuations. This valuation process is beneficial to the ongoing solvency of the insurance programs and equalized the amounts that our contract holders pay for their Fire and Hazard and Disaster coverages.

The CalVet Fire and Hazard property program continues to cover losses that are usually excluded or limited by most private insurance companies. One example is mold remediation coverage. The CalVet Fire and Hazard program covers mold remediation up to \$20,000 if the ensuing mold damage is caused by a covered peril, whereas commercial insurers are setting coverage limits of \$5,000 to \$10,000 on such mold losses. The CalVet Fire and Hazard coverage is truly another benefit for the veterans we serve.

\* Prorated **Excess Fire Insurance** calculation for the first two months (62 days) of FY 2010/2011 on this policy with an annual premium of \$612,656 was \$104,152:

$$(62/364 = 0.17) (\$612,656) = \$104,152.$$

**\*\* NOTE:** The Reinsurance premium of \$3,015,000 was split internally within CDVA for bookkeeping purposes with Disaster being charge 82.36% and Fire being charged 17.64%.

**\*\*\* Prorated Fire Reinsurance** for the last ten months (302 days) of FY 2010/2011, which was 17.64% of the Reinsurance premium of \$3,015,000 for this twelve month policy, was \$441,432:

$$(302/364 = 0.83) (17.64\% \times \$3,015,000 = \$531,846) = \$441,432.$$

**Total Excess Fire Insurance and Fire Reinsurance premiums were approximately \$545,584 (\$104,152 + \$441,432) for FY 2010/2011.**

## **Disaster Indemnity Coverage**

The Statutes of 1971 authorized Disaster Indemnity Coverage (DIC). Section 989.4 of the Military & Veterans Code requires the CDVA to maintain an Indemnity Fund. The fund indemnifies CalVet contract holders against the cost of repairing damage caused by flood, earthquake or other perils, such as mudslide, which are not covered by the Fire and Hazard insurance policy. The deductible per occurrence for every CalVet contract holder is \$500 for flood and \$500 or 5 percent of the covered loss, whichever is greater, for earthquake. (Most commercial insurers apply a 5 percent deductible to the replacement cost *value of the home, rather than on the covered loss*. Thus, in the case of a partial loss, the CalVet deductible provides much better coverage for the homeowner.) CalVet contract holders participate in the DIC by paying an annual assessment of \$1.50 per \$1,000 of replacement cost (insured) value, which is deposited in the Indemnity Fund.

To cover unexpected catastrophic losses, which may exceed the Indemnity Fund's self-insured retention, CDVA purchases group catastrophe insurance. Until September 1, 2010, commercial excess disaster (DIC) insurance was placed with insurance companies with coverage in the amount of \$50 million with a self-insured retention of \$4 million per occurrence and a \$100,000 per occurrence maintenance deductible thereafter. The excess disaster (DIC) insurance policy discussed in this report became effective on February 28, 2010 and was cancelled on September 1, 2010 when the CalVet Home Loan portfolio became Reinsured with eight (8) highly rated insurers, both domestic and international, including Lloyd's of London and the Bermuda market. The current program provides layered coverage between several different reinsurance providers with a Disaster deductible of \$4 million and \$46 million in reinsured coverage above the deductible for a total of \$50 million in coverage per occurrence. See NOTE below \*. Companies subject to greater loss exposure charge more per dollar of coverage because they must pay losses up to their total coverage as soon as the \$4 million deductible per occurrence is breached.

The premium paid by CDVA on February 28, 2010 for excess insurance to cover the Disaster Indemnity Program was \$3,847,166. Upon cancellation of that policy on September 1, 2010, the insurance carriers paid CalVet \$1,526,667.46 in return premium. On a prorated basis for the first two months of the Fiscal Year, this six month Excess Disaster DIC insurance policy cost CalVet approximately \$654,018 =  $(\$3,847,166) (62/364 = 0.17)$ . The premium paid by CDVA on September 1, 2010 for the combined Fire and Disaster Reinsurance was \$3,015,000. After allocation of that amount for the Disaster insurance versus the Fire insurance\*, and prorating for the Fiscal

Year, the Disaster (Earthquake & Flood, etc) Insurance portion of the Reinsurance premium was approximately \$2,061,018 =  $(302/364 = 0.83) (82.36\% \times \$3,015,000 = \$2,483,154)$ . Therefore, the total approximate excess Disaster and reinsurance Disaster premium was \$2,715,036 ( $654,018 + 2,061,018$ ) for FY 2010/2011.

\* NOTE: The Reinsurance premium of \$3,015,000 was split internally within CDVA for bookkeeping purposes with Disaster being charged 82.36% and Fire being charged 17.64%.

Annually, CalVet contract holders pay their pro-rata share to replenish the Disaster Indemnity Fund to cover the self-insured retention and deductible and pay the annual premiums for the excess commercial and reinsurance insurance coverage. Effective February 1, 2007, the annual rate was increased to \$1.50 per \$1,000 of insured value in order to cover the increased costs of claims and excess insurance premiums.

In the event the costs of disasters during a policy year exceed the \$4 million per occurrence deductible, the reinsurance coverage will assume additional claims losses up to \$50 million per occurrence and in the annual aggregate. (See the list below\*\*.) The Disaster Indemnity Fund will pay for claims not covered by reinsurance. In the event that the DIC fund could not cover such losses, the Disaster Indemnity Fund may borrow from the other three funds in the new CalVet Self Insurance Fund. If necessary, additional assessments from CalVet contract holders would be sought to replenish the Indemnity Fund. This has not occurred since the inception of the DIC program in 1971.

The costs to CalVet contract holders for the DIC are substantially less than similar coverage available through commercial insurance plans. In fact, there are no known coverages offered that can compare to the CalVet DIC Program. The DIC deductible for flood losses is only \$500.00. The earthquake deductible is \$500 or 5 percent of the covered loss, whichever is greater. This guaranteed-replacement coverage on earthquake losses is not provided or offered by any other insurance company, including the California Earthquake Authority. Most earthquake deductibles are 10 percent to 15 percent of the policy coverage amount, which in most cases is a minimum of \$10,000. All CalVet properties, including mobile homes and condominiums and planned-unit developments with blanket insurance policies, are covered under the DIC program.

During the 2010/2011 fiscal year due to various mild quakes throughout the state, the amount disbursed on behalf of our DIC claimants totaled \$195,638. Premiums received from CalVet contract holders totaled \$4,389,185. The cost to operate the DIC, exclusive of the

personnel cost for CDVA staff administering the program, but including the premium for excess commercial insurance coverage, reinsurance, claims payments, adjusting fees and claims expenses was \$2,920,736, which is based upon the following information:

• Prorated Excess Disaster Insurance (EQ & Flood)(Marsh)	\$ 654,018
• Prorated Disaster Reinsurance (Marsh)	\$2,061,018
• Claims Payments	\$ 195,638
• Claims Adjusting Fee (Sams)	\$ <u>10,062</u>
Total	\$2,920,736

For Fiscal Year 2010/2011, the Disaster Indemnity program had a net gain of \$1,468,449 (\$4,389,185 - \$2,920,736). The Disaster Indemnity Fund balance on June 30, 2011 was \$16,656,718.

**\*\* NOTE regarding Reinsurance Coverage:** In the unlikely event that the Per Occurrence Deductible of \$4 million is pierced, CalVet is contractually obligated to reinstate the reinsurance coverage for a new annual premium for the remainder of the policy year, prorated for the amount of the limit eroded by the loss for the affected layer(s).

## **Self-Insured Life and Disability Coverage**

The Home Protection Plan (HPP), comprised of self-funded life and disability coverage provided by the CDVA through a fund administered by the Pacific Life and Annuity Company (PLA), was discontinued on June 1, 1996. Only the CalVet loan holders who were disabled and qualified for disability benefits on that date remain in the vested legacy program. They will continue to be covered until they are no longer disabled or until the loan balance is paid in full. As of June 30, 2011, there were 33 loan holders receiving monthly self-funded disability benefits. Standard Insurance Company administers the HPP for CalVet. CDVA discontinued offering the self funded life and disability coverage to new loan holders on January 1, 1995, because of the extraordinary losses being experienced by the program.

During fiscal year 2010/2011, the Department paid a total of \$3,517 for the life coverage on behalf of the CalVet contract holders receiving self-funded disability benefits. Charges for life coverage for these contract holders are part of the installments paid by the coverage benefit, and are paid by the self-funded HPP reserve funds. Life claims for 2 participants totaled \$31,648.

During fiscal year 2010/2011, the Department paid a total of \$12,506 for the disability coverage on behalf of the CalVet contract holders receiving self-funded disability benefits. As a part of their disability benefit, these amounts are charged against the self-insured HPP reserve funds. Disability claims paid to participants during fiscal year 2010/2011, including the pay off of 35 loans by the Department from the Self Insured reserve fund, totaled \$533,693. As of June 30, 2011, the reserve fund for the legacy self insured program contains \$2,404,575, which will be used to pay for future disability and death benefits. Actuaries at Standard Insurance Company have completed calculations for the 33 loan holders still in the legacy self-insured portion of the CalVet portfolio. (Note: The actuaries at Standard used the 1987 Group Commissioners Table, at 5% interest, to generate the liability calculation). As of June 30, 2011, the liability is estimated to be \$1,090,196, and the Department has set aside \$2,404,575 to fund the outstanding liability.

The administrative cost paid to The Standard to operate the HPP for disability coverage totaled \$6,501 for fiscal year 2010/2011, exclusive of the costs of Department personnel administering the program. These costs will continue to decrease due to a reduction in the number of veterans covered by the legacy self-funded program and the substantial reduction in administrative fees as outlined in the Administrative Services Agreement dated February 1, 2003 and renewed on February 1, 2008, with Standard Insurance Company.



## **Commercial Life and Disability Insurance**

Under the plan with Standard Insurance Company that became effective on February 1, 2003, Standard was paying CDVA an administrative fee of 4 percent of the amount of premiums paid on life and disability coverage. Effective February 1, 2008, the new contract with Standard provides, at the option of CDVA, that this administrative fee of 4% would be deposited monthly into the CalVet Claims Fluctuation Reserve (CFR) account at the Bank of New York - Mellon (BNY - Mellon) for the purpose of helping to stabilize our life and disability insurance rates. If necessary, Standard Insurance can draw funds from this account to stabilize the life and disability insurance program. In October 2009, CDVA redirected the 4% administrative fee from the CFR account to CDVA to offset the Department's expenses for billing and collecting premiums from contract holders and the premium costs of coverage on delinquent contracts until their loan payments are current, or their loan contracts are cancelled. The total amount of the administrative fee for 2010/2011 was \$146,590.

## **Loan Insurance**

Since 1997, the Department has completed several programmatic changes, including obtaining loan insurance from a primary mortgage insurer (PMI) for certain existing Contracts of Purchase with high loan-to-value ratios (LTVs), and United States Department of Veterans Affairs (USDVA) loan guarantees or primary mortgage insurance for all new Contracts of Purchase (except home improvement loans) with LTVs above 80 percent.

During 2007/08 FY, the rating agencies downgraded all PMI companies because of the housing crisis. In addition, because of the high number of foreclosures in California, the PMI companies had essentially stopped writing policies in the state. Although some companies are again writing in California, their ratings are not very good. This renders PMI companies of little value in supporting CalVet bond ratings. The Department is exploring alternative methods of providing such coverage. A study is underway regarding a possible self-insured PMI coverage program for new CalVet borrowers whose LTV exceeds 80%. The lack of availability of commercial PMI may make it difficult to make some loans to prospective borrowers, and this is true for all segments of the California mortgage market place. The Department continues to pursue options of how to reduce PMI costs for the Department, which will ultimately reduce the up-front costs for veterans acquiring new loans.

## **USDVA Guaranty Program**

The Department was approved by the USDVA as a "supervised lender with automatic processing authority" as of March 10, 1998, which means we can process and fund loans prior to getting approval from USDVA. On July 27, 1998, the Department received USDVA approval under the Lender Appraisal Processing Program to process appraisals and determine reasonable value without prior USDVA review. The Department seeks USDVA loan guarantees for Contracts of Purchase with an LTV of 80 percent or higher, up to 100 percent.

The Department collects and pays to the USDVA a funding fee between 1.25 percent and 3.3 percent of the Contract of Purchase (loan) amount, based on the LTV for each Contract of Purchase on all contracts to be guaranteed by the USDVA. The buyer or the seller may pay this fee in escrow, or it may be added to the base loan amount, not to exceed the \$521,250 maximum loan amount with the funding fee added. For Contracts of Purchase with LTVs exceeding 80% that are not insured by USDVA, a funding fee between 1.25% and 3.3% of the base loan amount is collected at close of escrow and is deposited into the CDVA self insured PMI account (Loan Guarantee Fee account). For these contracts the funding fee may not be added to the base loan amount.

### **Primary Mortgage Insurance (PMI)**

In 1998 and 1999, the Department purchased mortgage insurance from Radian for a pool of existing Contracts of Purchase with LTVs above 80 percent. The Department purchased primary mortgage insurance from Radian on all new Contracts of Purchase (except home improvement loans) with LTVs between 80 percent and 97 percent that are not guaranteed by the USDVA. Under this agreement, as amended on December 13, 2006, Radian committed to insure Contracts of Purchase until the aggregate principal amount of Contracts of Purchase insured under the second policy and subsequent amendment reaches \$3.6 billion.

The Radian policies provide for coverage for aggregate losses incurred on Contracts of Purchase following property disposition above an aggregate 2 percent deductible based upon a percentage of the original insured balances of the Contracts of Purchase of the applicable pool. Under both Radian policies, once the applicable aggregate deductible has been reached, insurance claims may be made. Until the spring of 2008, a funding fee of up to 1.38 percent of the base loan amount was collected at close of escrow and used to purchase the Radian coverage. For these contracts the funding fee may not be added to the base loan amount.

Due to changes in the economic stability of Primary Mortgage Insurance (PMI) companies, the Department felt the need to find other avenues for PMI coverage. (Note: the Department takes its underwriting process seriously. With that in mind, we are making secure loans and, it should be noted, foreclosure losses are far below all other California figures. Therefore, we have not underwritten or devised loan products that have added to the PMI coverage meltdown.) Since we are in the process of devising other options to cover foreclosure losses, the decision was made to discontinue paying premiums to Radian, and to self-insure that portion of our portfolio. For Contracts of Purchase with LTVs exceeding 80% that are not insured by USDVA, a funding fee between 1.25% and 3.3% of the base loan amount is collected at close of escrow and is deposited into the CDVA self insured PMI sub-account (Mortgage Reserve sub-account). As of June 30, 2011, we have accumulated \$5,433,600 in the self-insured fund that will be used to pay for possible future losses to that portion of the CalVet portfolio. Radian still covers 2,839 homes in the CalVet portfolio.

## **CalVet Insurance Unit**

The entire CalVet Insurance Unit - Home Protection Program is administered internally in the Farm and Home Purchases Division by seven people. This includes: one Senior Property Agent (unit manager); four Associate Property Agents; one Junior Staff Analyst and one Program Technician II. The total staff budget allocation for fiscal year 2010/2011 was \$782,216, including salaries and wages, staff benefits, operating expenses and equipment.

## **Conclusion**

All of the Home Protection programs are financially stable, and we look forward to them continuing to be solvent for the next five years, with only minor revisions. In addition, by moving to Reinsurance from Commercial Excess Insurance, the CalVet property insurance program has gained more security through greater diversity of insurance carriers and a greater spread of the risks. As this report is being written, the Department continues investigating alternatives and options to commercial PMI, which essentially has not been available in the California market place since April 2008.